

BILLING CODE: 6720-01 P

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Part 563e

[No. 2004-53]

RIN 1550-AB48

Community Reinvestment Act -- Community Development, Assigned Ratings

AGENCY: Office of Thrift Supervision, Treasury (OTS).

ACTION: Notice of proposed rulemaking.

SUMMARY: In this notice of proposed rulemaking (proposal), OTS is proposing changes to, and soliciting comment on, its Community Reinvestment Act (CRA) regulations in two areas to reduce burden.

First, OTS is proposing to revise the definition of “community development” to encourage all savings associations to increase their community development lending, qualified investments, and community development services in rural areas, with a particular focus on increasing these activities in underserved nonmetropolitan areas. The proposal also solicits comment on further encouraging savings associations to perform community development activities in any areas affected by natural or other disasters or other major community disruptions.

Second, the proposal solicits comment on providing additional flexibility in assigning CRA ratings to encourage large retail savings associations to focus their community

reinvestment efforts on the types of activities the communities they serve need, consistent with safe and sound operations. As an alternative, the proposal solicits comment on eliminating the investment test.

Today's proposed changes are designed to reduce burden to the extent consistent with safe and sound supervision of the industry. They would further the CRA burden reduction OTS began in its final rule published in the Federal Register on August 18, 2004, which revised the definition of "small savings association." They would also further the burden reductions in the interim final rule published elsewhere in today's Federal Register as part of OTS's review of regulations under section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPA).

DATES: Comments must be received by [insert date 60 days following publication in the Federal Register].

ADDRESSES: You may submit comments, identified by No. 2004-53, by any of the following methods:

- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.
- **E-mail address:** regs.comments@ots.treas.gov. Please include No. 2004-53 in the subject line of the message and include your name and telephone number in the message.
- **Fax:** (202) 906-6518.
- **Mail:** Regulation Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention: No. 2004-53.

- **Hand Delivery/Courier:** Guard's Desk, East Lobby Entrance, 1700 G Street, NW., from 9:00 a.m. to 4:00 p.m. on business days, Attention: Regulation Comments, Chief Counsel's Office, Attention: No. 2004-53.

Instructions: All submissions received must include the agency name and docket number or Regulatory Information Number (RIN) for this rulemaking. All comments received will be posted without change to the OTS Internet Site at <http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1>, including any personal information provided.

Docket: For access to the docket to read background documents or comments received, go to <http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1>.

In addition, you may inspect comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment for access, call (202) 906-5922, send an e-mail to public.info@ots.treas.gov, or send a facsimile transmission to (202) 906-7755.

(Prior notice identifying the materials you will be requesting will assist us in serving you.)

We schedule appointments on business days between 10:00 a.m. and 4:00 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

FOR FURTHER INFORMATION CONTACT: Theresa A. Stark, Program Manager, Thrift Policy, (202) 906-7054; Richard Bennett, Counsel (Banking and Finance), Regulations and Legislation Division, (202) 906-7409, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

SUPPLEMENTARY INFORMATION:

Introduction

After considering the comments on a joint advance notice of proposed rulemaking (ANPR) published on July 19, 2001 (66 FR 37602), and a joint notice of proposed rulemaking (NPR) published on February 6, 2004 (69 FR 5729), OTS is proposing changes to, and soliciting comment on, its CRA regulations in two areas: (1) the definition of “community development” and (2) the assignment of ratings. These proposed changes are designed to reduce burden to the extent consistent with the safe and sound supervision of the industry. These changes would provide institutions with more flexibility to make their own determinations about how best to serve their communities. They would further the CRA burden reduction OTS began in its final rule published in the Federal Register on August 18, 2004, which revised the definition of “small savings association.” 69 FR 51155. They would also complement the burden reductions contained in OTS’s interim final rule published elsewhere in today’s Federal Register as part of OTS’s review of regulations under section 2222 of the EGRPRA (Pub. L. 104-208, Sept. 30, 1996). The related EGRPRA rule is reducing regulatory burden on savings associations by updating and revising various application and reporting requirements.

Community Development Proposal

OTS is proposing to revise the definition of “community development.” The proposal is designed to encourage all savings associations to increase their community development lending, qualified investments, and community development services in rural

areas, with a particular focus on increasing these activities in underserved nonmetropolitan areas. The proposal also solicits comment on further encouraging savings associations to perform community development activities in any areas affected by natural or other disasters or other major community disruptions. OTS is considering these revisions to encourage more community development activities in rural areas, to cover the full range of activities that should receive favorable consideration in all areas, and to reduce burden by affording savings associations greater flexibility in serving their communities.

The Current Rule

Under the current definition in section 563e.12(f) of OTS's regulation, "community development" means:

- (1) Affordable housing (including multifamily rental housing) for low- or moderate-income individuals;
- (2) Community services targeted to low- or moderate-income individuals;
- (3) Activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs (13 CFR 121.301) or have gross annual revenues of \$1 million or less; or
- (4) Activities that revitalize or stabilize low- or moderate-income geographies.

See 69 FR 41181, 41188 (July 8, 2004) (redesignating the definition of "community development" as paragraph (f) of section 563e.12, among other changes).

The 2001 ANPR

As discussed in the 2001 ANPR, “[S]ome [commenters] indicate that many projects intended to revitalize or stabilize rural communities do not qualify under the current regulatory definition of community development because they are not located in low- or moderate-income geographies as defined in the regulations. Others assert that the definition does not adequately value activities benefiting communities or projects involving persons with a mix of incomes.” 66 FR at 37605.

As explained in the preamble to the 2004 NPR, commenters on the 2001 ANPR were split over the appropriateness of the current definition of “community development.” Financial institutions asked the banking agencies to remove from the definition of “community development” the requirement that community development activities target primarily low- or moderate-income individuals or areas, and expand the definition to include community-building activities that incidentally benefit low- or moderate-income individuals or areas. For instance, several financial institutions contended that any activity that helps “revitalize and stabilize” an area (*e.g.*, after a natural disaster or a steady economic decline) should be considered community development, even if the activity is not located in, or targeted to, low- or moderate-income communities. Other examples of activities for which they sought consideration included municipal bonds and grants to cultural organizations and other charities. In contrast, community organizations that expressed a view favored retaining the current definition of “community development” or narrowing it. For example, many community organizations sought to limit the “economic

development” component of the definition to financing minority-owned businesses or farms and businesses or farms in low- or moderate-income areas. 69 FR at 5733.

The 2004 NPR

The 2004 NPR did not propose to revise the definition of “community development.” Thus, it did not specifically solicit comment on this issue and commenters did not focus on it. But as noted in the preamble to OTS’s August 18th final rule, community organizations opposed to changing the definition of “small institution” were primarily concerned that reducing the number of institutions subject to the large retail institution test—and therefore, the investment test—would reduce the level of investment in low- and moderate-income urban and rural communities. 69 FR at 51157. Further, some in Congress submitted comments encouraging the banking agencies to expand the definition of “community development.” A few other commenters supported giving more weight to philanthropy in underserved markets.

Today’s Proposal

Today’s proposal on the definition of “community development” would address rural areas as well as any areas affected by natural or other disasters or other major community disruptions.

With respect to rural areas, the second and fourth paragraphs of the community development definition would be expanded. Thus, under the proposed expanded definition, community development would also include: (1) community services targeted to individuals in rural areas; and (2) activities that revitalize or stabilize rural areas. Community

development activities in rural areas would be covered even if the individuals or areas served are not low- or moderate-income. This would contrast with the current definition of “community development,” which focuses on activities that benefit low- and moderate-income individuals or geographies.

OTS is proposing this change to reduce burden and provide greater flexibility. OTS is responding to concerns that competition for scarce CRA loans and investments in certain metropolitan areas not only disadvantages small institutions that cannot compete for quality CRA loans and investments, but also results in a largely urban CRA focus. OTS’s examination experience indicates that rural areas tend to be composed of mixed-income census tracts that may not qualify as low- or moderate-income areas. Expanding the definition of “community development” as proposed would further encourage savings associations to engage in community development activities outside of their traditional CRA market—while still applying existing standards for consideration of activities inside or outside the assessment area(s)—and thereby encourage the extension of CRA and community development to currently underserved and overlooked rural communities.

As explained in OTS’s August 18th final rule, even with respect to small savings associations, OTS already considers performance in making community development loans and qualified investments and providing community development services, at the savings association’s request, for purposes of raising a rating. 69 FR at 51159. Thus, the proposed change to the definition of “community development” is designed to encourage all thrifts—large and small—to increase their community development activities in rural areas, with a

particular focus on increasing these activities in underserved nonmetropolitan areas.

OTS is not proposing a specific definition of “rural” at this time. However, it solicits comments on the appropriate definition below.

The proposal also solicits comment below on further encouraging savings associations to perform community development activities in any areas affected by natural or other disasters or other major community disruptions. This portion of the proposal would not be limited to rural areas or activities targeted to low- or moderate-income individuals or low- or moderate-income geographies. OTS has not, however, included proposed rule text that would address this possible change.

Solicitation of Comment on Community Development Proposal

OTS solicits comments on all aspects of this proposal.

A. Solicitation of Comments on the Definition of “Community Development”

1. Should the definition of “community development” be expanded? If so, how?
2. Does the proposed change to the community development definition encompass the full range of community development activity that benefits rural areas? Should the definition include a savings association’s demonstrated participation in other types of community activities? Should the regulation provide for the Director of OTS to determine that additional activities that benefit the public welfare constitute “community development?”
3. OTS has indicated in the wake of natural disasters and the September 11th terrorist attacks, that it would take into account an institution’s response to its community when

evaluating the institution's stabilization activities under CRA. Would it be appropriate for the definition of "community development" to expressly provide that community development also includes, in any area (rural or not, low- or moderate-income or not): (1) community services targeted to individuals in areas affected by natural or other disasters or other major community disruptions; and (2) activities that revitalize or stabilize areas affected by natural or other disasters or other major community disruptions? What other types of major community disruptions should be covered (*e.g.*, civil unrest, arson)?

4. As proposed, OTS would not expand the first paragraph of the definition of "community development" to include affordable housing (including multifamily rental housing) for individuals in rural areas who are not low- or moderate-income. Would it be appropriate to cover such activities? Do such activities contribute to community development? If so, how? Are there difficulties with housing affordability and availability in rural areas (*e.g.*, marketability on the secondary mortgage market) that could appropriately be addressed by revising the definition of "community development?"
5. As proposed, OTS would not expand the third paragraph of the definition of "community development" to include activities that promote economic development by financing businesses or farms in rural areas without regard to their size or gross annual revenues. Would it be appropriate to cover such activities? Do such activities contribute to community development? If so, how? Are there difficulties with financing business or farms of various sizes or gross annual revenues in rural areas that could appropriately be

addressed by revising the definition of “community development?”

6. What would be the impact of the proposed definitional change for purposes of the community development test for wholesale or limited purpose savings associations, the large retail institution test, the small savings association test, and any other provisions of the CRA regulation affected?

B. Solicitation of Comment on the Definition of “Rural”

1. Would a definition of “rural” be helpful? If so, how should “rural” be defined?
2. Would the definition of “nonmetropolitan area,” which is to be incorporated in section 563e.12(r) of OTS’s CRA regulation, be appropriate (*i.e.*, any area that is not located in a metropolitan statistical area)? *See* 69 FR at 41188. This definition is derived from the Office of Management and Budget’s Standards for Defining Metropolitan and Micropolitan Statistical Areas. 65 FR 82228 (December 27, 2000). However, OMB has indicated, “The Metropolitan and Micropolitan Statistical Area Standards do not equate to an urban-rural classification; many counties included in Metropolitan and Micropolitan Statistical Areas, and many other counties, contain both urban and rural territory and populations.” OMB Bulletin No. 04-03 (February 18, 2004), *available at*, www.whitehouse.gov/omb/bulletins/fy04/b04-03.html.
3. Are there other definitions that would be appropriate? For example:
 - a. The U.S. Census Bureau classifies as “urban” all territory, population, and housing units located within an urbanized area (UA) or an urban cluster (UC). It delineates UA and UC boundaries to encompass densely settled territory, which consists of:

(1) core census block groups or blocks that have a population density of at least 1,000 people per square mile and (2) surrounding census blocks that have an overall density of at least 500 people per square mile. In addition, under certain conditions, less densely settled territory may be part of each UA or UC. The Census Bureau's classification of "rural" consists of all territory, population, and housing units located outside of UAs and UCs. The rural component contains both place and nonplace territory. Geographic entities, such as census tracts, counties, metropolitan areas, and the territory outside metropolitan areas, often are "split" between urban and rural territory, and the population and housing units they contain often are partly classified as urban and partly classified as rural. *See* "Census 2000 Urban and Rural Classification," *available at* www.census.gov/geo/www/ua/ua_2k.html.

- b. The U.S. Department of Agriculture (USDA) uses various definitions.
 - i. One definition groups counties according to their official status as metropolitan or nonmetropolitan under OMB standards. It then applies 9 rural-urban continuum codes to further distinguish among metropolitan counties by size and nonmetropolitan counties by their degree of urbanization or proximity to metropolitan areas. Codes 1 through 3 are various types of metropolitan counties while codes 4 through 9 are various types of nonmetropolitan. Within nonmetropolitan areas, Code 8 is a county that is completely rural or has less than 2,500 in urban population and is adjacent to a metropolitan area, while Code 9 is a county that is completely rural or has

less than 2,500 in urban population and is not adjacent to a metropolitan area.

See “What is Rural?” available at www.nal.usda.gov/ric/faqs/ruralfaq.htm

and “Measuring Rurality: Rural-Urban Continuum Codes,” available at

www.ers.usda.gov/briefing/rurality/RuralUrbCon.

- ii. Another definition, contained in the Farm Security and Rural Investment Act of 2002, applies generally to the USDA’s Rural Community Advancement programs. It defines “rural” and “rural area” generally to mean “any area other than a city or town that has a population of greater than 50,000 inhabitants; and the urbanized area contiguous and adjacent to such a city or town.” 7 U.S.C. 1991(a)(13).
- iii. Another definition, applicable to the Rural Empowerment Zones and Enterprise Communities initiative, generally defines a “rural area” as consisting of any area that lies outside the boundaries of a Metropolitan Area, as designated by OMB, or an area that has a population density less than or equal to 1,000 persons per square mile, the land use of which is primarily agricultural. 7 CFR 25.503(a).

Assigned Ratings Proposal

OTS is soliciting comment on providing additional flexibility in the way that CRA ratings are assigned. This change would reduce burden and encourage large retail savings associations to focus their community reinvestment efforts on the types of activities the communities they serve need, consistent with safe and sound operations. As an alternative

way to reduce burden, the proposal solicits comment on eliminating the investment test.

The Current Rule

Under the CRA regulation at 12 CFR 563e.28(b), OTS assigns ratings to savings associations assessed under the lending, investment, and service tests in accordance with the following three rating principles:

(1) A savings association that receives an “outstanding” rating on the lending test receives an assigned rating of at least “satisfactory”;

(2) A savings association that receives an “outstanding” rating on both the service test and the investment test and a rating of at least “high satisfactory” on the lending test receives an assigned rating of “outstanding”; and

(3) No savings association may receive an assigned rating of “satisfactory” or higher unless it receives a rating of at least “low satisfactory” on the lending test.”

The Interagency Questions and Answers Regarding Community Reinvestment, 66 FR 36620 (July 12, 2001), address how the banking agencies weight performance under the lending, investment, and service tests for large retail institutions. Q&A 28(a)–3, 66 FR at 36639, provides:

A rating of “outstanding,” “high satisfactory,” “low satisfactory,” “needs to improve,” or “substantial noncompliance,” based on a judgment supported by facts and data, will be assigned under each performance test. Points will then be assigned to each rating as described in the first matrix set forth below. A large retail institution’s overall rating under the lending,

investment and service tests will then be calculated in accordance with the second matrix set forth below, which incorporates the rating principles in the regulation.

The Q&A then sets forth the following matrices (66 FR at 36639-36640):

Points Assigned for Performance Under Lending, Investment and Service Tests

	Lending	Service	Investment
Outstanding	12	6	6
High Satisfactory	9	4	4
Low Satisfactory	6	3	3
Needs to Improve	3	1	1
Substantial Noncompliance	0	0	0

Composite Rating Point Requirements
[Add points from three tests]

Rating	Total points
Outstanding	20 or over.
Satisfactory	11 through 19.
Needs to Improve	5 through 10.
Substantial Noncompliance	0 through 4.

Note: There is one exception to the Composite Rating matrix. An institution may not receive a rating of “satisfactory” unless it receives at least “low satisfactory” on the lending test. Therefore, the total points are capped at three times the lending test score.

As reflected in the first matrix, currently approximately 50 percent weight is given to lending, and approximately 25 percent weight is given to services and investments each.

Under section 563e.21(b) of OTS’s CRA regulation, OTS applies the tests in a performance context that considers the following:

(1) Demographic data on median income levels, distribution of household income, nature of housing stock, housing costs, and other relevant data pertaining to a savings association’s assessment area(s);

(2) Any information about lending, investment, and service opportunities in the savings association's assessment area(s) maintained by the savings association or obtained from community organizations, state, local, and tribal governments, economic development agencies, or other sources;

(3) The savings association's product offerings and business strategy as determined from data provided by the savings association;

(4) Institutional capacity and constraints, including the size and financial condition of the savings association, the economic climate (national, regional, and local), safety and soundness limitations, and any other factors that significantly affect the savings association's ability to provide lending, investments, or services in its assessment area(s);

(5) The savings association's past performance and the performance of similarly situated lenders;

(6) The savings association's public file, as described in section 563e.43, and any written comments about the savings association's CRA performance submitted to the savings association or the OTS; and

(7) Any other information deemed relevant by the OTS.

The CRA regulation has been implemented to consider factors outside of a savings association's control that prevent it from engaging in certain activities. When the banking agencies promulgated the 1995 CRA rule, they specifically noted in the preamble:

Statutory limits on investment authority. Several thrift commenters had concerns about the application of the investment test to thrift institutions

because of their limited investment authority. Rather than providing a blanket exemption from the investment test, the final rule modifies the “capacity and constraints” section of the performance context to clarify that examiners should consider an institution’s investment authority in evaluating performance under the investment test. *A thrift that has few or no qualified investments may still be considered to be performing adequately under the investment test if, for example, the institution is particularly effective in responding to the community’s credit needs through community development lending activities.*

60 FR 22156, 22163 (May 4, 1995) (emphasis added).

This flexible approach for evaluating the performance of savings associations was restated in the interagency CRA Qs&As. These Qs&As specifically acknowledge that limitations on institutional capacity and constraints will be considered in evaluating performance under the investment test. Q&A 21(b)(4)–1 asks, “Will examiners consider factors outside of an institution's control that prevent it from engaging in certain activities?”

66 FR at 36631. The answer provided states:

Yes. Examiners will take into account statutory and supervisory limitations on an institution's ability to engage in any lending, investment, and service activities. *For example, a savings association that has made few or no qualified investments due to its limited investment authority may still receive a*

low satisfactory rating under the investment test if it has a strong lending record.

66 FR at 36631 (emphasis added).

The CRA regulation also emphasizes that the rating assigned reflects the savings association's record of helping to meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, "consistent with the safe and sound operation of the savings association." 12 CFR 563e.21(c). The CRA regulation goes on to elaborate in 12 CFR 563e.21(d):

Safe and sound operations. This part and the CRA do not require a savings association to make loans or investments or to provide services that are inconsistent with safe and sound operations. To the contrary, the OTS anticipates savings associations can meet the standards of this part with safe and sound loans, investments, and services on which the savings associations expect to make a profit. Savings associations are permitted and encouraged to develop and apply flexible underwriting standards for loans that benefit low- or moderate-income geographies or individuals, only if consistent with safe and sound operations.

The 2001 ANPR

The 2001 ANPR contained extensive discussion of the way performance of large retail institutions is assessed under the lending, investment, and service tests. It explained that the regulations attempt to temper their reliance on quantitative factors by requiring

examiners to evaluate qualitative factors, because not all activities of the same numerical magnitude have equal impact or entail the same relative importance when undertaken by different institutions in different communities. It also indicated that institutions' CRA ratings reflect the principle that lending is the primary vehicle for meeting a community's credit needs. It noted that in the preamble to the 1995 CRA rule, the banking agencies published a ratings matrix for examiners to use when evaluating large retail institutions under the lending, investment, and service tests. Under this matrix, it is impossible for an institution to achieve a "satisfactory" rating overall unless it receives at least a "low satisfactory" rating on the lending test. 66 FR at 37604.

In publishing the matrix in 1995, the banking agencies noted that they were not incorporating it into the CRA rule itself, to allow some flexibility to adjust the matrix to prevent unintended anomalies that may be found during the examination process. The preamble noted that if the banking agencies were to change the matrix in the future, the new matrix would be published for information, but not necessarily for comment, in the Federal Register. 60 FR at 22170. As discussed above, the matrix is currently published in Q&A 28(a)–3.

With respect to the emphasis placed on each category of an institution's activities under the large retail institution test, the 2001 ANPR indicated that some contended that lending should always be stressed, because they believe that deposits derived from communities should be reinvested in those communities through loans. Still others asserted that lending should be the only basis upon which institutions are evaluated. 66 FR at 37604.

In contrast, some questioned whether lending should be emphasized more than investments and services. Some asserted that a CRA evaluation should allow for adjustment of this emphasis in a manner that more nearly corresponds with the activities of the institution and the particular needs of its community. For example, some asserted, that if an institution does not significantly engage in retail lending and, therefore, makes few loans, the lending test should not receive more emphasis than the investment and service tests for that institution's CRA evaluation. 66 FR at 37604.

Further, some argued that an institution's record of providing services should be given more emphasis than it currently is given. Others asserted that providing services is not relevant to assessing whether an institution is meeting the credit needs of its community. 66 FR at 37604.

The 2001 ANPR asked: "Do the regulations strike the appropriate balance between quantitative and qualitative measures, and among lending, investments, and services? If so, why? If not, how should the regulations be revised?" 66 FR at 37604.

The 2001 ANPR also discussed, in detail, and solicited comment on, each of the component parts of the large retail institution test. With respect to the investment test, it explained that the banking agencies included the investment test in their CRA regulations in recognition that investments, as well as loans, can help meet credit needs. Some asserted, however, that the banking agencies should only consider investment activities to augment institutions' CRA ratings. In their view, although investments may help an institution to meet the credit needs of its community, particularly in low- and moderate-income areas,

CRA ratings should be based primarily on lending activity. Still others stated, however, that it is inappropriate for the banking agencies to evaluate investments under the CRA as a means of meeting credit needs. Yet others argued that investments by financial institutions are invaluable in helping to meet the credit needs of the institutions' communities, particularly in low- and moderate-income areas. 66 FR at 37604-37605.

The 2001 ANPR also noted that the availability of qualified investments has been an issue of concern to some. Although some observed that, since the 1995 regulations went into effect, the market of available CRA-related investments has grown and continues to grow, others asserted that appropriate investment opportunities may not be available in their communities. Further, some of the retail institutions subject to the investment test indicated that, in some cases, it was difficult to compete for investment opportunities, particularly against much larger institutions. 66 FR at 37605.

The 2001 ANPR asked: "Does the investment test effectively assess an institution's record of helping to meet the credit needs of its entire community? If so, why? If not, how should the regulations be revised?" 66 FR at 37605.

With respect to the service test, the 2001 ANPR discussed issues of concern on both evaluating retail services and community development services. It asked: "Does the service test effectively assess an institution's record of helping to meet the credit needs of its entire community? If so, why? If not, how should the regulations be revised?" 66 FR at 37605.

In summarizing the comments on the 2001 ANPR, the preamble to the 2004 NPR indicated a majority of community organization commenters that addressed the weight

given to the components of the three-part test believed that lending should continue to receive more weight than investments or services. Of financial institutions that addressed the issue, more than half agreed. The remainder of industry commenters generally believed either that the components should be weighted equally or that their weights should vary with performance context. Many financial institutions felt the investment test was weighted too heavily, while community organizations disagreed. 69 FR at 5732.

The preamble also explained that although a small number of commenters objected to any consideration of investments under CRA, the comments revealed a general view that community development-oriented investments (“qualified investments,” under the regulations) should be considered to the extent they help meet community credit needs. Commenters, nonetheless, disagreed significantly about whether the current investment test effectively and appropriately assesses investments and about the extent to which assessment of investments should be mandatory or optional.

As the preamble explained, financial institutions commented that the investment test is not sufficiently tailored to market reality, community needs, or institutions’ capacities. Several financial institutions said there are insufficient equity investment opportunities, especially for smaller institutions and those serving rural areas. Some noted that intense competition for a limited supply of community development equity investments has depressed yields, effectively turning many of the investments into grants; some claimed that institutions had spent resources transforming would-be loans into equity investments merely to satisfy the investment test; and some expressed concern that institutions were forced to

worry more about making a sufficient number and amount of investments than about the effectiveness of their investments for their communities. 69 FR at 5732-5733.

To address these concerns, many financial institutions favored abolishing the stand-alone investment test and making investments optional to one degree or another. Only two financial institutions expressly supported retaining the separate investment test. Several financial institutions and most financial institution trade associations endorsed one or more of the following three alternatives: (1) treat investments solely as “extra credit;” (2) make investments count towards the lending or service test; or (3) treat investments interchangeably with community development services and loans under a new community development test. 69 FR at 5733.

In contrast, the majority of community organization commenters urged the banking agencies to retain the investment test. Many of them claimed that the problem is more often a shortage of willing investors than an insufficient number of investment opportunities. Community organizations also contended that grants and equity investments are crucial to meeting the affordable housing and economic development needs of low- and moderate-income areas and individuals. They stated, for example, that investments support and expand the capacity of nonprofit community development organizations to meet credit needs. A few community organizations acknowledged a basis for some of the financial institutions’ complaints concerning the investment test, but most of those community organizations argued that refining, rather than restructuring, the large retail institution test would address such complaints. 69 FR at 5733.

The preamble to the 2004 NPR also discussed comments received on issues of concern under the service test. 69 FR at 5734-5735.

The 2004 NPR

The preamble to the 2004 NPR explained that the three-part large retail institution test places primary emphasis on lending performance, and secondary emphasis on investment and service performance. It explained in detail the reasons that the banking agencies, at that time, did not propose to eliminate the investment test, modify the service test, or change the weights given to the three tests under the large retail institution test. 69 FR at 5733-5735. Thus, it did not specifically solicit comments on these issues. Nor did the 2004 NPR propose or specifically solicit comments on the possibility of retaining all three tests as part of the large retail institution test but providing additional flexibility in the way that CRA ratings are assigned. Thus, the comments received did not focus on these possibilities either.

A few commenters on the 2004 NPR, however, indicated their continued support for creating a community development test that would incorporate all community development lending, community development investments, and community development services into a single test. A few commenters also urged the banking agencies to give more weight to certain types of services in the CRA rating.

Today's Proposal

OTS is soliciting comment on providing additional flexibility in assigning CRA ratings. The purpose would be to reduce burden while encouraging large retail savings

associations to focus their community reinvestment efforts on the types of activities the communities they serve need, consistent with safe and sound operations. Rather than mandating changes to the weights assigned to lending, investments, and services under the large retail institution test, OTS is soliciting comment on providing flexibility in those weights.

This approach would serve to clarify and build upon the existing guidance currently contained in Q&A 21(b)(4)–1 discussed above addressing the application of the investment test to savings associations. Notwithstanding the Q&A and the statement in the 1995 preamble also discussed above, OTS has heard anecdotal evidence suggesting that further elaboration would be useful.

The existing guidance reflects the unique statutory and regulatory structure applicable to savings associations. Savings associations remain home mortgage lenders, in part, because unlike banks, they must have at least 65% of their assets in the form of what are generally mortgages or mortgage-related loans in order to avoid the adverse consequences of failing to meet the qualified thrift lender test under the Home Owners' Loan Act (HOLA). 12 U.S.C. 1467a(m). Savings associations are also subject to HOLA lending and investment limits, including limits on commercial loans and community development investments. 12 U.S.C. 1464(c)(2)(A) and (c)(3)(A); 12 CFR 560.30. *See* 69 FR at 51158.

To bring further clarity to the issue, OTS is considering providing each savings association evaluated under the large retail institution test a choice, at its option, on the

weight given to lending, investments, and services in assessing its performance. Consistent with the traditional and appropriate emphasis on lending, OTS would not allow less than a 50 percent weight to lending. The remaining 50 percent would weigh lending, investments, or services, or some combination thereof, based on the savings association's election. As a result, each savings association could choose to have OTS weigh lending anywhere from 50% to 100% for that association's overall performance assessment, services anywhere from 0% to 50%, and investments anywhere from 0% to 50%.

As under the existing ratings matrix, OTS would continue to allocate a total of 24 possible points among the three tests. OTS would allocate 12 of these possible points to lending. OTS would allocate the remaining 12 possible points to lending, services, investments, or some combination thereof based on the savings association's weight election. For each test, the savings association would receive a percentage of the possible points it allocated to that test, with the percentage varying depending on the rating it received on that test as follows:

<u>Rating on Test</u>	<u>% of Points Allocated to Test Association Would Receive</u>
Outstanding	100%
High Satisfactory	75%
Low Satisfactory	50%
Needs to Improve	25%
Substantial Noncompliance	0%

For illustrative purposes, here are some examples:

1. Lending 80% Weight, Service 10% Weight, Investment 10%. If a savings association chose to be evaluated by OTS giving 80% weight to lending, 10% weight to services, and 10% weight to investment, OTS would apply the following matrix:

Points Assigned for Performance Under Lending, Investment and Service Tests

	Lending (80%)	Service (10%)	Investment (10%)
Outstanding	19.2	2.4	2.4
High Satisfactory	14.4	1.8	1.8
Low Satisfactory	9.6	1.2	1.2
Needs to Improve	4.8	.6	.6
Substantial Noncompliance	0	0	0

2. Lending 50% Weight, Service 10% Weight, Investment 40%. If a savings association chose to be evaluated by OTS giving 50% weight to lending, 10% weight to services, and 40% weight to investment, OTS would apply the following matrix:

Points Assigned for Performance Under Lending, Investment and Service Tests

	Lending (50%)	Service (10%)	Investment (40%)
Outstanding	12	2.4	9.6
High Satisfactory	9	1.8	7.2
Low Satisfactory	6	1.2	4.8
Needs to Improve	3	.6	2.4
Substantial Noncompliance	0	0	0

3. Lending 50% Weight, Service 30% Weight, Investment 20%. If a savings association chose to be evaluated by OTS giving 50% weight to lending, 30% weight to services, and 20% weight to investment, OTS would apply the following matrix:

Points Assigned for Performance Under Lending, Investment and Service Tests

	Lending (50%)	Service (30%)	Investment (20%)
Outstanding	12	7.2	4.8
High Satisfactory	9	5.4	3.6
Low Satisfactory	6	3.6	2.4
Needs to Improve	3	1.8	1.2
Substantial Noncompliance	0	0	0

Under all of these alternatives, the composite rating matrix would remain essentially the same as currently provided except for taking into account the possibility of fractions of points. It would read as follows:

Composite Rating Point Requirements [Add points from tests as applicable]

Rating	Total points
Outstanding	20 or over.
Satisfactory	11 or more but less than 20.
Needs to Improve	5 or more but less than 11.
Substantial Noncompliance	0 or more but less than 5.

Note: There is one exception to the Composite Rating matrix. An institution may not receive a rating of “satisfactory” unless it receives at least “low satisfactory” on the lending test. Therefore, the total points are capped at three times the lending test score.

Continuing to include the same note to the composite rating matrix as contained under the current matrix would have certain implications. For example, a savings association opting to allocate equal weight to lending as to the combination of services and investments could not receive a rating of “satisfactory” overall if it received a “needs to improve” or “substantial noncompliance” on its lending.

If OTS were to offer this type of flexibility, a savings association evaluated under the large retail institution test could elect weights, much in the same way as it may currently elect consideration of lending by an affiliate or consortium, or investments or services by an

affiliate. *See* 12 CFR 563e.22(c)-(d), 563e.23(c), and 563e.24(c). The Preliminary Examination Response Kit (PERK) package could be revised to provide an opportunity for a savings association to opt for an alternative weight for lending, service, and investment. Through this process, a savings association could make a new weight election at the start of each CRA examination. A savings association that did not make an election would be evaluated under the existing matrix contained in Q&A 28(a)–3.

Conforming changes could be made section 563e.28 of the CRA rule. Additional text could be added to that section indicating that a savings association could, at its option, elect to have its rating assigned under alternative weights of lending, service, and investment so long as at least 50 percent weight is given to lending.

To the extent of any inconsistency between the three rating principles in section 563e.28(b) discussed above and the rating matrix generated from the savings association's election, the standards set forth under the matrix selected would govern. Thus, for example, the principle referring to ratings on the service test and investment test would not apply to a savings association that chose not to have OTS give weight to either or both of those factors.

Providing flexibility for a savings association to elect alternative weights would supplement the use of the performance context factors discussed above and serve many of the same functions. As discussed above, OTS already evaluates a savings association's performance in the context of factors such as the savings association's product offerings and business strategy, its institutional capacity and constraints, information about lending, investment, and service opportunities in the savings association's assessment area(s), and

demographic and other relevant data pertaining to a savings association's assessment area. *See* 12 CFR 563e.21(b). Likewise, providing weight alternatives would enable the savings association to have its performance evaluated in a manner most appropriately tailored to the lending, investment, and service opportunities its assessment area(s), demographic and other relevant data pertaining to its assessment area(s), its product offerings and business strategy, and its institutional capacity and constraints. This approach would be designed to encourage large retail savings associations to focus their community reinvestment efforts on the types of activities the communities they serve need, consistent with safe and sound operations.

Solicitation of Comment on Assigned Ratings Proposal

OTS solicits comments on all aspects of this proposal.

C. Solicitation of Comment on Alternative Weights Election

1. Would it be appropriate to provide the savings association flexibility in the way that CRA ratings are assigned by offering a choice of weights for the lending, service, and investment tests within the large retail institution test? If so, why? If not, why not?
2. Are there ways OTS could make the process even more flexible than outlined in this proposal?
3. What would be the impact on lending, investments, and services of offering alternative weights?
4. Should OTS place limits on the savings association's ability to opt for particular weights? How could OTS help ensure that a savings association would select weights that focus on the types of activities the communities it serves need? How could OTS

take a savings association's selection of a weight alternative into consideration as part of the performance context? Is there an appropriate role for public participation beyond existing opportunities for provision of information regarding the performance context and submission of comments about the savings association's CRA performance? *See* 12 CFR 563e.21(b)(2), 563e.21(b)(6), 563e.29(c) and 563e.43(a)(1) and Q&A 21(b)(2)–2, 66 FR at 36631.

5. What logistical and practical issues would have to be addressed in providing a choice of weights and how should these issues be addressed (*e.g.*, timing and method of alternative selected)?
6. Would it be useful for OTS to publish examples of weight alternatives in the preamble to the final rule or elsewhere?
7. For ease of administrative implementation, would it be appropriate for OTS to limit the choice of weights to a list containing several options? Is so, what options should be offered? Which options would a savings association be likely to choose?
8. Would it cause confusion for savings associations, community organizations, or the public to allow customized weight combinations that might be selected by only one or a few institutions (*e.g.*, lending 57%, service 28%, and investment 15%)?
9. Would it be appropriate for the alternative weights to require at least a 50 percent weight to lending, as proposed? Why or why not? If a rating matrix that gives less than 50

percent weight to lending were to be offered, would that be consistent with the purposes of CRA?

10. Would it be appropriate to continue to ensure that a savings association may not receive a rating of “satisfactory” unless it receives at least “low satisfactory” on the lending test by capping total points at three times the lending test score as under the current composite rating matrix, as proposed? Why or why not? If a rating matrix that allowed a savings association to receive a rating of “satisfactory” without receiving at least “low satisfactory” on the lending test were offered, would that be consistent with the purposes of CRA?

11. Is it appropriate to offer alternatives allowing less than a 25 percent weight to services and less than 25 percent weight to investments, as proposed? Why or why not?

D. Solicitation of Comment on Eliminating the Investment Test

1. Would a preferable alternative be to eliminate the investment test? If so, why? If not, why not?
2. What would be the impact on investments of eliminating the investment test?
3. If the investment test were eliminated as a mandatory separate component of the large retail institution test, should investments still be considered . . .
 - a. At a savings association’s option or to raise a rating?
 - b. Within one of the other tests (*e.g.*, under the lending test treated similarly to community development loans)?
 - c. In some other fashion (*e.g.*, treating investments interchangeably with community

development services and loans under a new community development test)?

4. If the investment test were eliminated as a mandatory separate component of the large retail institution test, what weight should be given to the remaining components of the test (*e.g.*, weight lending 75% and service 25%, weight lending and service 50% each)?

Regulatory Analysis

Paperwork Reduction Act

In accordance with the requirements of the Paperwork Reduction Act of 1995, OTS may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. This collection of information is currently approved under OMB Control Number 1550-0012. This proposal would not change the collection of information.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act, OTS certifies that since the proposal would not have a significant economic impact on a substantial number of small entities. It would not impose any additional paperwork or regulatory reporting requirements. It would simply encourage savings associations to increase their community development lending, qualified investments, and community development services in rural areas, with a particular focus on increasing these activities in underserved nonmetropolitan areas, by expanding the definition of “community development.” The proposal also solicits comment on further encouraging savings associations to perform community development activities in areas affected by natural or other disasters or other major community

disruptions. The other portions of the proposal relate only to the treatment of savings associations under the retail test mandated only for large institutions.

Executive Order 12866 Determination

OTS has determined that this proposal is not a significant regulatory action under Executive Order 12866.

Unfunded Mandates Reform Act of 1995 Determination

Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. 104-4 (Unfunded Mandates Act) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. OTS has determined that this rule would not result in expenditures by State, local, and tribal governments, or by the private sector, of \$100 million or more. Accordingly, OTS has not prepared a budgetary impact statement nor specifically addressed the regulatory alternatives considered.

List of Subjects

12 CFR Part 563e

Community development, Credit, Investments, Reporting and recordkeeping requirements, Savings associations.

OFFICE OF THRIFT SUPERVISION

12 CFR CHAPTER V

For the reasons outlined in the preamble, the Office of Thrift Supervision proposes to amend part 563e of chapter V of title 12 of the Code of Federal Regulations as set forth below:

PART 563e-COMMUNITY REINVESTMENT

1. The authority citation for part 563e continues to read as follows:

Authority: 12 U.S.C. 1462a, 1463, 1464, 1467a, 1814, 1816, 1828(c), and 2901 through 2907.

2. Revise § 563e.12(f) to read as follows:

* * * * *

(f) Community development means:

* * * * *

(2) Community services targeted to low- or moderate-income individuals or to individuals in rural areas;

* * * * *

(4) Activities that revitalize or stabilize low- or moderate-income geographies or rural areas.

Dated: November 18, 2004

By the Office of Thrift Supervision

James E. Gilleran,
Director.